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October 22, 1997

M:

Re: Change in Ownership - Termination of Trust Resulting in Distribution of Interests in Legal Entities

Dea:

This is in reply to your letter of September 9, 1997 addressed to Assistant Chief Counsel in which you request a legal opinion on whether certain transfers of interests in legal entities will result in changes in ownership of real property owned by those legal entities. To summarize the facts of your letter, in 1966, your clients' grandfather ("the settlor") set up an irrevocable family trust which trust provided for the establishment of 12 separate irrevocable sub-trusts ("grandchildren's trusts") for the benefit of each of the settlor's grandchildren. The grandchildren's trusts each received a proportionate share of the cash initially contributed to the family trust based upon a "per stirpes" allocation, 1/18 to six grandchildren and 1/9 to six other grandchildren, and the cash was used to purchase interests in various general partnerships and limited liability companies, several of which own real property. In exchange, each sub-trust received a proportionate share of the interests purchased in each of the legal entities. The sole beneficiary of each sub-trust is the grandchild for whom that sub-trust was created. Your clients wish to terminate the Family Trust and each of the sub-trusts and to distribute the interests in the legal entities held by the sub-trusts to each beneficiary grandchild. As a result, each grandchild would become a general partner in each of the general partnerships and a member of each LLC.

In your view, the transfer of the legal entities' interests from the sub-trusts to the individual grandchildren will not result in changes in ownership of the real property owned by the legal entities pursuant to Revenue and Taxation Code section 62, subdivision (a)(2). We agree with your conclusion as to no changes in ownership, although for another reason set forth below, that the termination of the irrevocable trusts and distribution of the assets to the sole present beneficiaries of those trusts does not result in changes in ownership.

Law and Analysis

For purposes of change in ownership, when a trustor creates and transfers property into an irrevocable trust in which a person other than the trustor or the trustor's spouse is the present

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beneficiary, the trustor-transferor is considered to have transferred the present beneficial interest in the property to the present beneficiary of the trust. Such a transfer results in a change in ownership pursuant to Revenue and Taxation Code section 60 because it constitutes "a transfer of a present interest in the property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." When the Family Trust and sub-trusts were created, the present beneficial interest in the cash used to fund the trusts vested in the beneficiaries, each of whom was the sole income beneficiary of his or her trust. When the sub-trusts used their cash to purchase interests in legal entities, those interests also became vested in the present beneficiaries. Since the sub-trusts were irrevocable, the present beneficiaries of each sub-trust at that time became the indirect owners of the property held by the partnerships and LLCs.

When an irrevocable trust terminates and the property interests held by the trust are distributed to the present beneficiaries, there are no transfers of the present beneficial interests and, therefore, no changes in ownership occur. In this regard, Property Tax Rule 462.160, subdivision (d)(1) provides

(d) Exceptions. A transfer resulting from the termination of a trust is not a change in ownership if:

(1) Prior Reappraisal. Termination results in the distribution of trust property according to the terms of the trust to a person or entity who received a present interest (either use of or income from the property) causing a reappraisal when the trust was created, or when it became irrevocable; provided, however, change in ownership also occurs when the remainder or reversionary interest becomes possessory if the holder of that interest is a person or entity other than the present beneficiary.

Amendments to Rule 462.160 were recently adopted, and final approval from the Office of Administrative Law is pending; however, those amendments did not have any substantive effect on these provisions of subdivision (d)(1).


Although the trusts are distributing ownership interests in legal entities, several of which own real property, rather than real property interests, the same principle applies. The present beneficial owners of these ownership interests held by these irrevocable trusts are the grandchildren. Therefore, the termination of the trusts and the distributions of the ownership interests to them as individuals will not result in changes in ownership of the underlying real properties. The case of *Allen v. Sutter County Bd. of Equalization* (1983) 139 Cal.App.3d 887 is applicable to the facts presented here. In that case, grandparents created a trust in 1961 for the benefit of their grandchildren, the present beneficiaries. In 1978, after the passage of Proposition 13, the trust was terminated and the real property distributed to the present beneficiaries, the grandchildren. The assessor determined that the real property had undergone a change in ownership and reassessed the property accordingly. The court, however, held that a change in ownership did not occur upon termination of the trust. Rather, the change in ownership occurred in 1961 when the present beneficial interests in the grandchildren had been created. When the

trust was terminated, the grandchildren received legal title only. They had already held beneficial ownership.

Furthermore, because the grandchildren became the present beneficial owners of the partnerships and LLCs shortly after the creation of the sub-trusts and remained so after the termination of the sub-trusts, there is no transfer of ownership interests which might trigger changes in ownership of the real properties owned by the legal entities. Hence, the distribution of the interests should not be cumulated or counted for purposes of subdivision (d) of Revenue and Taxation Code section 64, and no person or entity will be acquiring "control" within the meaning of subdivision (c) of section 64.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,


Louis Ambrose
Tax Counsel

LA:ba

cc: Mr. Dick Johnson \

Policy, Planning, & Standards Division

Ms. Jennifer Willis

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